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(a) ECONOMIC COOPERATION AMONG DEVELOPING COUNTRIES:
- FINANCING OF SOUTH-SOUTH TRADE (PARAGRAPH 4(c)(iii) OF RESOLUTION 4(V) OF THE COMMITTEE ON ECONOMIC COOPERATION AMONG DEVELOPING COUNTRIES)

Evaluation of performances and issues of trade financing in developing countries: The case for and the viability of an interregional facility

Report by the UNCTAD secretariat

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CONTENTS

		Paragraphs
I.	EXECUTIVE SUMMARY	1 - 12
II.	THE ISSUE OF TRADE FINANCE IN DEVELOPING COUNTRIES: REVIEW AND EVALUATION	13 - 45
	A. Trade financing performance of developing countries	19 - 27
	B. The role of commercial banks and central banks in export financing	28 - 34
	C. Regional and subregional export financing	35 - 40
	D. Conclusions and observations	41 - 45
III.	THE CASE FOR AN INTERREGIONAL TRADE FINANCING FACILITY	46 - 67
	A. Meeting the prospective requirements of intra-developing-country trade	47 - 50
	B. Risk-spreading and risk-pooling	51 - 52
	C. Additionality and access to financial markets	53 - 58
	D. Economies of scale	59
	E. Cost advantages	60
	F. Market niche	61
	G. Standardization of procedures, papers, rating and legal characteristics	62
	H. Auxiliary benefits	63 - 67
IV.	A PROPOSAL FOR AN INTERREGIONAL TRADE FINANCING FACILITY	68 - 102
	A. Outline of the services of the proposed facility	70 - 75
	B. Commercial viability	76 - 77
	C. Scope of operation and country coverage	78 - 80
	D. Risk management	81
	E. Guarantees and insurance	82 - 86
	F. Types of facilities and financing	87 - 89
	G. Capitalization	90 - 93
	H. Asset and liquidity management	94 - 95
	I. Financial feasibility analysis	96 - 98
	J. Results and evaluation	99 - 102
V.	RELATED ISSUES	103 - 118
	A. Action-list recommendations on developing country financial infrastructure	103 - 107
	B. International export guarantee facilities	108 - 111
	C. Membership and participation of developed countries	112 - 113
	D. Institutional aspects	114
	E. Capital shares and membership classes	115 - 116
	F. The role of local focal points	117
	G. Rating of export credit paper and standardization	118

Annex: Summary of individual scenario results

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I. EXECUTIVE SUMMARY

1. In subparagraph 4 (c) (iii) of resolution 4 (V) adopted by the Committee on Economic Co-operation among Developing Countries at its fifth session on 12 June 1989, the Committee called upon the Secretary-General to "undertake, in cooperation with relevant international organizations, a study on the problems of trade financing in developing countries and in particular on how to further support and strengthen existing mechanisms in this area, as well as the feasibility of establishing a commercially viable interregional mechanism for financing South-South trade in non-traditional exports based on participation from developing countries and with a financial structure based on paid-in capital from participating countries, and to present the study to the first part of the thirty-seventh session of the Trade and Development Board for consideration".1/

2. In pursuance of that request, the UNCTAD secretariat sought the views of Governments and international financial institutions on several technical aspects of the issue. In order to facilitate these consultations, a detailed questionnaire was sent to a selected number of developing countries and territories and international agencies 2/ regarding their existing export financing arrangements and future needs. The responses to that questionnaire are reflected in the analyses contained in background document TD/B/1300/Supp.1 entitled "Trade financing in developing countries: an assessment and evaluation of existing schemes and future requirements", which surveys trade financing in developing countries both as an issue and as an institutional practice.

3. Along with this survey which responds to the first part of the relevant provisions of resolution 4 (V), the secretariat approached practitioners in the area of trade-finance about carrying out a market-based report assessing the need and financial feasibility of establishing an interregional trade financing facility (ITFF) among developing countries. The results of this collaboration are set forth in background document TD/B/1300/Supp.2 entitled "Feasibility study for an interregional trade financing facility for the exports of non-traditional goods of developing countries".

4. The present report provides in section I a statement of the problem at hand and its setting. Section II makes an overall examination and evaluation of the situation of trade financing in developing countries. Section III presents the case for a possible ITFF. In section IV, a specific proposal for such a facility is outlined. The feasibility of the proposal is gauged financially in terms of key ratios calculated by simulating ten operational scenarios based on various assumptions. Changes in the key parameters of the base case were simulated to measure the sensitivity of the financial viability of the proposal to changes in the assumptions. The sensitivity analyses allow for a range of alternatives which, taken together, represent a reasonable and realistic set of outcomes. In closing, the report affords in section V a brief consideration of some related issues and follow-up courses of action.

5. The main conclusion of this report is that there is a fairly substantial case for establishing an interregional trade financing facility. This conclusion stands on three pillars. The first is the present institutional and functional gaps evidenced in the infrastructure of trade financing of

developing countries and the disadvantageous position of their exporters. The second pillar consists of the benefits, advantages and operational merits of a possible facility. These include meeting the present and prospective needs of non-traditional exports; the cost savings and gains from economies of scale of the facility; the decrease in portfolio risk as a result of diminution of aggregate risk; the disassociation of country and credit risks together with the spreading of trade financing risk among countries; the accrual of financial additionality; and the specialization and "standardization effects" emanating from the facility. All of these are in addition to a host of auxiliary other benefits. Lastly, the third pillar is the financial feasibility of the proposal demonstrated under the various scenarios. This feasibility is shown to be robust under a whole range of changes in the key assumptions and parameters.

The problem and the setting

6. Trade-financing is a problem area for developing countries. However, the scale of the problem differs for different exporters. In particular, traders in non-traditional exports face the most acute manifestations of this problem. In traditional exports, such as commodities, the typical developing country exporter usually needs post-shipment financing. Traditionally, banks, whether national or international, have extended short-term credits (bridging-loans) against letters of credit, trade documents, warehouse certificates, etc., for 90-180 days. Since most such exports have gone to developed countries, banks have often known the importer or his bank and could easily locate credit information about them. Naturally, more complications arise if the importer is from a developing country, as such importers and their Banks are not always known to the exporter and his bank. None the less, until the eruption of the debt crisis in 1981 and the severe access problems of developing countries which have arisen in its aftermath, access to finance for traditional exporters has been more or less one of cost. In recent years, however, even in the case of traditional exports like grain, the needed credits have been six months to one year.

7. The situation in other branches of trade - i.e., in non-traditional exports - is quite different. 3/ The typical exporter in such a trade usually requires pre-shipment finance in foreign exchange as well as post-shipment finance. He, therefore, is not always in possession of the necessary trade documentation against which credits can be extended. Moreover, such an exporter needs medium to long-term credits running up to five years. When he is exporting to another developing country, his counter-party, the importer, is usually unknown to his bank or to his national export-credit institution. The exporter himself might also be a new one or one exporting to a new market with unknown marketing and performance risks. Hence, such an exporter presents altogether a different type of risk from that of the traditional exporter. He needs different types of financing at different stages of the production-exporting process.

8. In most developing countries, the financial structure is not well enough developed to accommodate non-traditional exporters. Only 16 developing countries are found to have fully-fledged export-financing facilities with requisite specialization. In most cases, the trade financing infrastructure is plagued with gaps and when institutions do extend such

credits, they are heavily tied to collateral and limited to low percentages of the values of the trade involved. Moreover, the resources that developing countries can divert to export-financing especially those in foreign exchange are limited and plainly inadequate to the task. This is one of the manifestations of under development and it will not in the short run meet with an easy solution.

9. International banks, which have in the past financed traditional exports, show little interest in extending medium to long-term export credits, and much less interest in granting pre-shipment credits. When they do so, it is for a customer they know and deal with or for a very large and creditworthy trader. Moreover, in typical cases they assess the credit risk also with a view to the country risk, and this is especially the case in intra-developing-country trade.

10. The situation of a similar exporter in a developed country is radically different. The financial structure in developed countries reveals no gaps: there is a continuum of specialized agencies and suitable financing facilities. The credit-worthiness evaluation assesses the credit risk without adding it to country and foreign-exchange risks; it is a domestic transaction. It should be recalled in this context that buyer-credits, i.e. trade-finance, have come to be a very decisive factor in export competitivity in non-traditional trade. 4/ Consequently, a typical developing-country exporter is at relative disadvantage in various ways.

11. This problem has to be solved by developing countries if their efforts to liberalize their trade and increase their exports are to succeed. However, since in the short run they cannot generate an adequate increase in their savings, nor allocate more to export financing at the expense of other uses, nor significantly increase their foreign-exchange earnings, the solution must come through international cooperation. Such cooperation can take place either regionally or interregionally and with the help of their developed-country partners. It goes without saying that everybody benefits from trade expansion and that world trade grows with increased intra-developing-country trade. While it is possible to effect such cooperation at the national or regional levels, <u>interregional</u> cooperation promises more benefits, savings, cost advantages and possible additionalities.

12. To deal with this problem the conceptual approach adopted here consists in determining first whether the existing financial structure shows major problems which call not only for national action but also for international cooperation. If so, then the merits, benefits and possible advantages of an interregional facility are to be examined. Subsequently, a specific proposal is outlined and simulated for determining its financial feasibility and gauging the sensitivity of this feasibility under changes in assumptions.

II. THE ISSUE OF TRADE FINANCE IN DEVELOPING COUNTRIES: REVIEW AND EVALUATION

13. Trade in goods and services gives rise to two types of flows: the flows of goods and services in one direction and the flows of payments in the other direction. However, the flow of goods and services can take place without the concomitant flow of payments. This means that trade relations imply often a trade-credit relationship.

14. An efficient trade financing system requires the existence of well-functioning basic mechanisms with self-evident goals, namely:

(i) the provision of export credits;

(ii) the provision of some form of guarantees for export credit in its various forms;

(iii) the refinancing and rediscounting of trade-finance instruments.

15. Trade financing comes from three sources: financing from domestic sources in local currencies, financing from foreign-exchange reserves, and financing and/or refinancing, in hard currency, from foreign sources.

16. The current efforts of developing countries to liberalize and expand their mutual trade have brought to the forefront the inadequacy of the trade financing systems of various countries both in terms of overall capacity and of their structural constituents. This in turn has raised the question whether it is possible or feasible to provide some multilateral trade financing that could supplement national schemes as well as attenuate the balance-of-payments difficulties arising from export financing on credit.

17. In formulating national policies, governments often put too much emphasis on examining whether the inaccessibility to export credit is due primarily to imperfect financial market conditions, rather than to micro factors pertaining to "own" financial means, the profile of future earnings of the exporter and indeed the viability of his operations. In other words, very little emphasis is usually placed on internal factors as opposed to external factors.

18. This report takes the view that the inaccessibility of trade finance for most exporters stems from both external and internal factors, i.e. from imperfect market conditions as well as lack of capital, and future uncertainty in relation to repayment and the foreign-exchange constraint of the monetary authorities. It is argued that the problem of access to trade finance by exporters from developing countries arises at least in part because of the difficulties in estimating risk and uncertainty associated with the future export performance of the borrower, and that such an assessment needs specialized trade institutions. That implies that the problem of access to trade finance reflects, inter alia, the particular difficulties of small and medium-sized exporters, and in particular the starting difficulties of new exporters, at least as much as the underdevelopment of the institutional financial infrastructure and the reluctance, if not the unwillingness, of international financial houses to extend trade finance for a considerable part of developing-country trade.

A. Trade financing performance of developing countries

19. The survey carried out by the secretariat covered 33 countries, out of a total of more than 120. The respondents included most of the countries with financing and/or refinancing facilities.

20. In addition, supplementary data indicate that some 57 countries have various facilities of trade financing or refinancing or some form of export credit insurance or guarantees. However, only 16 countries can be said to have fully-fledged schemes of a comprehensive and specialized nature; eight countries have guarantee and/or insurance schemes and 33 countries have rather rudimentary financing and/or refinancing schemes. Hence, the factual situation at the national level indicates that less than one half of developing countries have some form of trade financing or guarantees.

21. The number of countries with facilities does not, however, depict well the condition of the trade financing infrastructure or its capacity. With very few exceptions - i.e. 16 countries - the agency in question is not a specialized trade financing one. Central banks, which are the prime monetary institutions, are heavily involved in trade financing primarily through their discount windows. While their beneficial presence is understandable from a pragmatic institutional point of view, they are hardly, as is shown below, in a position to operate harmoniously therein. In general, the situation is bereft of specialization. And specialization is important for a proper assessment of the risk involved, especially that emanating from micro-factors of relevance to the enterprise involved. Moreover, in the case of new exporters or exports to new markets, non-specialized institutions are usually in possession neither of information nor operational experience which would permit the assessment of the creditworthiness of the other side of the transaction. They are also unable to provide access to relevant networks in financial markets. Lastly, non-specialization means that the institution involved has no market niche. Hence, trade financing becomes at best subsidiary to other functions such as banking services, or at worst, subject to the primacy of other objectives such as monetary control in central banking.

22. As table 2 of TD/B/1300/Supp.1 shows, the relative amounts of trade covered are typically low. It ranges from 0.5 per cent to 20.5 per cent of total non-traditional exports. In the case of the Republic of Korea it goes up to $US 67 million with most of the countries clustering around the range of $10-16 million (1986-1989).

23. Another aspect of the topography is that almost all the credits extended are short term, running up to a maximum of 180 days (table 4 of TD/B/1300/Supp.1). While, for commodity and other traditional exporters, such credits might be suitable, the same can hardly be said for non-traditional exporters whose needs call for medium-term credits running up to several years in the case of capital products and services. In the circumstances, intra-developing-country trade in non-traditional exports seems to lack specialized and suitable financial underpinning.

24. Turning to the terms and conditions of extended export credit, tables 4 and 7 of the above-cited document show that the magnitudes of the interest rates seem generally favourable and might imply a significant element of

subsidy. However, it is not possible to evaluate such rates in comparison with similar OECD ones. First of all, these rates are tied to local currencies with significant inflationary components varying from one country to another. But even if the real rates were compared, comparisons of net effective rates are not possible because, in many OECD countries, export credit is blended with aid components and the available data do not provide a basis for calculating weighted net rates. Moreover, in some developing countries, charges are tied to domestic rates in the form of compensation margins, which further complicates comparisons. In this connection, it should be pointed out that a large comparative subsidization of the rates is not desirable. Beyond securing a level playing-field for developing country exporters, subsidization is a breeding ground for inefficiency and a definite drain on alternative uses, i.e. investments of scarce national savings.

25. The bulk of export credits is not only extended on short term, but it is also coupled to heavy collateral requirements. And in all cases, barring a handful of exceptions, it is in the form of post-shipment credits. Pre-shipment credit, which is essential for non-traditional exporters (i.e. producers of capital goods and certain classes of manufactures), is hardly practised in developing-country trade financing. 5/ This situation reflects a multi-faceted problem: banks prefer to extend working-capital loans in the traditional manner and not as advances against order or potential contracts, while exporters who cannot resort to export-credit insurance prefer cash or sight papers for settlement. 6/ This attitude is understandable in view of the small number of credit insurance schemes (eight only), and the length of the requisite credit evaluation. In order to save costs, banks prefer their own regular lending procedures. As a result of all of this, pre-shipment lending is rare and costly.

26. In the aftermath of the debt crunch, even such meagre resources as were allocated by developing countries to export credit suffered financial stringencies. In the heavily indebted countries, there was evidence of suspension of credit lines, of a decline in commitments and disbursements and, in general, of unsteadiness of export credit levels. This unsteadiness coincided also with the drying up of export credits from international sources as a consequence of lumping other debt, with trade-based debt, thereby adding to the dimensions of export credit shortages.

27. The secretariat report (TD/B/1300/Supp.1) reconfirmed the well-known proposition that trade credit of developing countries is mostly primary financing. That is, it is financing with little possibility of refinancing from market and other secondary sources. This is hardly surprising because refinancing is usually bound up with (a) the existence of guarantees or insurance schemes; (b) a standardized system of paper rating; and (c) the existence of refinancing clearing houses or institutions. Without these, trade-credit debt is difficult to turn over as a negotiable security in the à forfait market or to refinance from specialized institutions or from the bond market. Consequently, since refinancing is rare, the resources of export finance institutions revolve only to the extent of either the back-payment streams they receive or the increase of their capital base.

B. The role of commercial banks and central banks in export financing

28. Domestic commercial banks play a certain role in "trade financing"; 7/ they have financed trade to the extent that such assets are a part of their banking business. This means that, typically, a banker would grant financing to customers who have also other banking business. That implies that small exporters or exporters that are not customers would only qualify to the extent that their creditworthiness, evaluated in the usual banking manner, would be favourable. It follows that it would not be the export contract or the trade transaction involving an importer which is the focus of the credit allocation decision, but rather the creditworthiness of the exporting firm itself. Since banks ration credit and are not trade financing houses, trade financing is usually considered in relation to other assets (loans and investments) as a residual asset. Hence, it is not a prime banking asset; it is at best incidental to other banking relationships and a second-best preference in lending. Moreover, even when domestic commercial banks extend credit, in the majority of cases they have extended export-credit and not seller trade credit. And even when an exporter can bring a satisfactory guarantee, the banks would face, in this case, the foreign-exchange constraint binding on the central bank when they ask for foreign-exchange or rediscount their loans with the central bank.

29. Commercial banks, aside from the norms they use for evaluating creditworthiness, consider the "shipping capacity" of the exporter rather than his "production capacity". Hence, the base of their lending is only a certain percentage of the business, i.e. the volume of the orders involved. Moreover, since they consider credit applications on a case-by-case basis, the processing involves two delays: delays in evaluating the application itself and delays in getting central bank refinancing on a preferential basis. This is aggravated when the rules stipulate application by the head office of the bank and not the branch involved. Between the disbursement of the loan and obtaining, ex post, central bank refinancing, there might be time lapse during which the commercial bank lends at a comparatively low interest rate. Accordingly, the negotiated rates and commissions tend to reflect such potential losses a priori.

30. In contrast to this behaviour of domestic banks, international banks have traditionally financed commodity trade by granting bridging loans for up to 180 days against collateral, shipping documents, or warehouse certificates. But they have not shown any preference for financing non-traditional exports. When international banks have gone beyond the financing of traditional exports, they have confined themselves to established customers of their developing-country branches - usually big, well-known firms - and concentrated on trade whose other side, the importer, is known to them or is located in their headquarter country. Hence, their role in South-South trade, and particularly in non-traditional exports financing, has been marginal and is likely to remain modest in the future.

31. The evidence reviewed in TD/B/1300/Supp.1 clearly substantiates this analysis and further indicates the extreme conservatism of the banking stance on trade financing in developing countries. This is shown by the small sums involved (up to 15 per cent of the trade); by the heavy collateral demanded; by the preponderance of short-term considerations in banks' export lending; by

the absence of medium-term lending at fixed rates; by the small trade credits extended to importers (as opposed to export finance), and by the clear reluctance to extend credits to indirect exporters. In addition, banks being non-specialized export finance institutions, they are revealed as reluctant to extend pre-shipment financing, except as lending for working capital, and do not seem to assess the credit risk of an export transaction in isolation from their customer relationship with the exporter.

32. This institutional underdevelopment has elicited intervention by the public sector in a great number of developing countries. Except in the 16 cases of fully-fledged export finance institutions, the State involvement is usually channelled through the central banks. Since central banks are among the best staffed and most highly specialized of developing country institutions, it is understandable that they have been called upon to fill an institutional void. TD/B/1300/Supp.1 documents this role in tables 5 and 6 and shows the variety of forms central bank export financing takes.

33. Central banks enter export financing mainly by refinancing bank assets at a preferential rate. The percentage of refinancing is rather low, ranging in most cases according to the latest data between 0.5 per cent and 38 per cent of total exports. Moreover, even if they hold domestic letters of credit and purchase orders, indirect exporters are usually not covered by the reach of central bank preferential rates. In 19 respondent countries, only loans to direct exporters were reported to be refinanced by the central banks.

34. The problem in relation to central banks is that, since they are charged mainly with carrying out monetary policy and overseeing the operations of commercial banks, export financing is not only wholly outside their experience but often clashes with their function of monetary control, be it in the form of controlling the monetary base or in the form of controlling the central interest rates. If a clash arises, obviously no central bank would sacrifice monetary control to considerations of export financing. Even if, at a given period, there is consistency between monetary objectives and export finance volumes and rates, a shift in monetary policy could certainly throw off any previous consistency. In this connection, attention must be drawn to shifts necessitated by stabilization programmes of the IMF type, where the volume of bank credit is targeted and mandated on the central bank. In short, the objectives of monetary policy are by no means harmonious with export finance requirements and, being short term in nature, they cannot, unless by sheer coincidence, maintain consistency with the rather long-term nature of export financing needs. And since central banks are not specialized in export finance, they bear the same shortcomings as commercial banks. Finally, even when the central bank is willing to discount the trade paper or extend the credit involved, if such credit as a pre-shipment lending to non-traditional exporters involves foreign-exchange, the limitations of these resources binds hard on trade financing.

C. Regional and subregional export financing

35. There are two types of institutions under this rubric: the multilateral funding institutions, i.e. the regional banks, and the developing country regional or subregional institutions.

36. As to the multilateral regional banks - the Asian Development Bank, the African Development Bank and the Inter-American Development Bank - the involvement of the first two in export financing has been at the level of expressing intellectual interest. The Inter-American Development Bank has a facility for trade financing which has been in operation only in recent years. The other multilateral regional banks have only recently shown an interest in trade financing. This is both understandable and justifiable in terms of funding specialization and competing priorities.

37. As regards developing country regional/subregional institutions, there are at present seven such institutions with varying characteristics and track records. These are: the Banco Latinoamericano de Exportaciones (BLADEX), Ecobank, the Andean System for the Financing of Subregional Trade (SAFICO), Arab Trading Financing Programme, the Islamic Development Bank, the Central American Integration Bank and the PTA Eximbank. All in all, 51 countries have potential and overlapping access to these banks (tables 8 and 9, in TD/B/1300/Supp.1).

38. All regional banks combined extended an accumulative amount of $US 1.7 billion of trade credits, the equivalent of 2.8 per cent of the total value in 1988 of non-traditional exports to other developing countries. However, this small amount masks great differences in the volumes of finance extended by individual institutions and the terms and conditions attached thereto. The bulk of export credits was provided by BLADEX and the import financing facility of the Islamic Development Bank. Both the Ecobank and the Arab Trade Financing Programme have started operations recently. Only three of these institutions refinance trade paper, while the others grant primary financing only. And only two - the Inter-American Development Bank and the Islamic Development Bank - specialize in medium to long-term trade financing.

39. One dominant characteristic of the regional institutions seems to be their inability to mobilize external resources from secondary sources. In fact, only one of them, BLADEX, has been able to mobilize external resources ($US 330 million since 1980).

40. The conclusion emerges that regional institutions are still minor contributors to trade financing. The majority of them do not provide medium and long-term credit. Except for one of them, they have not been able to mobilize external resources. Nor have they provided a context for international cooperation on trade finance, because of their limited membership and the absence of developed countries from all but two of them. It is also evident that they have not been able to link up interregionally and hence promote interregional claim settlements.

D. Conclusions and observations

41. The preceding sections demonstrate the various shortcomings, problems and gaps in the infrastructure of developing-country trade-financing. The factual evidence given here and the supplementary documents show that, in terms of institutions, only 16 developing countries have specialized trade-finance institutions. In most cases, it is the central banks and/or commercial banks that handle trade financing. Not only are both of these institutional types non-specialized in the matter, but both approach trade finance as subsidiary

to other objectives or second-best to other assets as the case may be. The coverage of credit available for trade-financing is limited; it ranges between 0.5 per cent and 20.6 per cent of exports to other developing countries and the volume reaches up to 66 per cent of the transaction, with most cases clustering around 10-16 per cent. Such volumes place developing-country exporters at a distinct disadvantage with regard to finance availability. Furthermore, the reach of the credit is usually limited to direct exporters. It is attached to heavy collateral and the great bulk of it is for short terms (up to 180 days). While short-term credit might be suitable for traditional exporters, it is entirely inappropriate for the needs of non-traditional exporters. And when the importer in such a trade is from another developing country, the availability of such credit finance is altogether uncertain.

42. The evidence points out that pre-shipment credit is particularly difficult to obtain and rare. Banks seem to prefer granting working-capital loans rather than export-credit because they fit better with their credit practices and evaluation criteria and are a part of their customary banking business with their clients. The rarity of pre-shipment credit affects non-traditional exports since it is mostly traders in this branch that need such a credit. Moreover, in pre-shipment credit, there is often a need for foreign-exchange to finance imports, the availability of which is subject to the posture of the balance of payment.

43. The difficulties of commercial trade-financing are relieved neither by government intervention in the vast majority of countries nor by international banks, which are shown to privilege established customers or traders with collateral banking business. This means, in effect, that big firms or old customers or importers in their home countries may expect relief from this corner but not small traders, or traders to new markets or traders with other developing countries. Moreover, all international banks superimpose country risk on credit risk in their creditworthiness evaluation so that a trade contract financeable for a developed-country exporter might not be so for a developing-country exporter.

44. The question therefore arises whether developing countries can individually resolve these problems. If it is accepted that all developing countries have a problem of savings shortages (relative to their investment requirements) then any increased allocation of savings to export financing must be at the expense of either domestic private investment or public expenditure, or must come from surplus in the basic payments balance. 8/ It might be possible to do that in a handful of newly industrialized countries, but certainly not in those developing countries now reeling under heavy indebtedness or in the less advanced ones with limited access to external finance or in those of lagging economic performance.

45. Hence, international cooperation is imperative in this area. The first level of such cooperation is regional/subregional. Regional and subregional banks, like any multilateral funding facility, offer several advantages. They can pool risks and spread non-national trade risks over several countries. They provide a context for international cooperation. They are, if properly managed, capable of getting as good an access to financial markets as the most creditworthy countries. Lastly, they are in a position to standardize trade papers and procedures. But this cooperation has borne insignificant results.

For one thing, the scope of the underlying intraregional or subregional trade might not offer the best trade complementarity. After all, regional affinities are geographic, cultural and historical rather than economic in nature. It is evident that trade complementarity is usually greater interregionally than in smaller contexts. The evidence also shows that interregional trade has been the most resistant to shocks and the most dynamic component of intradeveloping-country trade. Furthermore, any of the merits and arguments in favour of regional/subregional cooperation such as risk-pooling and spreading, scale economies, specialization, market niche, access to external resources and so on are likely to be greater on an interregional scale. Thirdly, the developed countries have not, on the evidence, flocked to the regional/subregional institutions of developing countries. Fourthly, most of the regional/subregional facilities that now exist will have to alter their charters and established modes of practice, let alone augment their resources, to answer developing-country needs in non-traditional South-South trade. The existing regional/subregional facilities are predominantly involved in North-South trade, and the three that extend non-traditional export-financing cover countries with specific, extra-economic, characteristics. Finally, except for BLADEX, the rest have not been able to secure additionality via access to secondary financing from international markets. Consequently, an international effort on an interregional scale of developing countries may profitably do two things: explore the possibility to establish a trade finance mechanism, and simultaneously, undertake a series of national measures to improve their existing national schemes. This report provides in section V.A. an action list of measures that can be carried out by the national authorities.

III. THE CASE FOR AN INTERREGIONAL TRADE FINANCING FACILITY

46. Against the topography surveyed in section II, the case for an interregional trade financing facility (ITFF) may be argued in terms of the demonstrated institutional and functional gaps of developing countries and the problem they face. However, of equal importance is the relationship of trade-finance availability and the prospects for growth of intra-group trade in general and that of non-traditional trade in particular among developing countries. This involves on the one hand the prospects for growth of this trade and, on the other, the short-fall of finance availability under the most probable scenarios. The case for an ITFF stands also on the probable benefits that a properly designed and operated facility would secure for its members, even those that are without a debt problem and more advanced than other developing countries.

A. Meeting the prospective requirements of intra-developing-country trade

47. Trade among developing countries was the most dynamic component of international trade in the 1970s: it had the highest rate of growth and the widest possible prospects. In the 1980s, even though the prospects remained the same, the data told a different story. Nevertheless, non-traditional exports and, as a whole, interregional developing-country trade resisted best the forces of decline in the 1980s. As demonstrated in the annex to TD/B/1300/Supp.1 and table 10 therein, non-traditional exports, the sector where the trade-financing shortages are most pronounced, amounted to some $US 62 billion by 1988. The prospects for growth in this sector are considerable and exceed, on any reasonable expectation, those of other branches. This would also conform to the shifts evidenced in the 1980s in the structure of trade and the active liberalization of trade policies of developing countries. Hence, non-traditional exports are likely to grow at a higher average rate than other components of developing-country trade. As was argued above, this trade will also face the greatest financing difficulties.

48. Non-traditional exports are also important from a development point of view. Since they represent a more evolved state of industrialization and a greater extent of diversification, they are associated with more advanced stages of economic development. Consequently, a greater number of developing countries would be expected to enter this trade. There are substantial advantages in this trend for the developing countries. The products involved in non-traditional trade - some classes of manufactures, capital plant and equipment goods and services and so on - have more advanced technologies embodied in them and greater value added. They imply increased demand for natural resources and for some primary commodities. Moreover, the production of these more evolved products carries with it forward and backward links with other sectors of the economy. And the production of these goods is associated with productivity gains from scale-economies and from shifting labour out of underemployed sectors. Such products also involve gains in marketing experience, quality control and design. All of this joins forces with the known and well-established multiplier and growth effects of trade.

49. There is reason to believe that the potential of non-traditional exports exceeds by a wide margin the present size of this trade - $US 62 billion. This can be shown by inspecting both the export pattern of developing

countries to the rest of the world and their import pattern from the rest of the world. Such inspection reveals that many developing countries installed production capacity in non-traditional goods and services in excess of exports to other developing countries and that, simultaneously, some such goods are imported from developed countries on account of quality difference, performance records or the technology embodied. If there is room for further trade, then there should be some reason for not having exploited the potential involved. This reason would encompass no doubt all the factors that explain why trade has not taken place: for example, transportation, marketing, access problems and the financial factors as well. As a case in point, the projection of non-traditional exports, in the low-case scenario set out in TD/B/1300/Supp.1, is some 2 per cent above the finance availability as extrapolated from past trends. This implies that the products and services underlying such a trade will either not materialize if finance is not available or that the markets would not finance such a trade because of a variety of imperfections, one of which is risk perception and assessment. Both situations imply a presumption of missed potential. 9/ The creation of an ITFF would help to remedy this market failure.

50. The projections referred to above indicate a range of growth in the low-case scenario of 5.5 per cent annually. That implies an annual trade expansion of $US 4 to $US 4.5 billion initially and a higher figure thereafter. Under the high-case projections, the growth rate and corresponding trade size are higher. Of this growth rate, some 2 per cent is in excess of finance availability if this latter is projected to continue growing at the same rate as it did in 1980-1987 - a rather optimistic assumption. In other words, in the best circumstances, there would be an annual finance gap in this sector of at least $US 1.5 billion to be filled by institutional development.

B. Risk-spreading and risk pooling

51. Because of the medium- to long-term nature of the financing required, most developing countries are not in a position to bear individually the risks of financing non-traditional trade. Spreading this risk among them and their developed-country partners is both necessary and beneficial.

52. A properly designed facility would be in a position to pool the risk of its portfolio assets and hence reduce the aggregate portfolio risk. This pooling would require a large and diversified portfolio and a significant heterogeneity of the underlying trade transactions. An international facility is more likely to have such attributes than any individual developing-country portfolio and certainly more so than that of a small developing country. Given the limited relative diversification of a typical developing country, the aggregate risk of a portfolio based on the trade of several countries should be substantially less than that of a portfolio of the same size with less diversified trade. The risk should also rapidly diminish with more membership.

C. Additionality and access to financial markets

53. Additionality involves two dimensions: the first relates to a country; the second relates to a certain amount of funds, in effect, the capital base

of a facility. Whereas the first dimension involves access to funds by a given country, the second involves the facility's access to secondary financing. A properly designed ITFF would be an improvement in the additionality sense on what individual developing countries can manage on their own. The facility would grant access to its resources to some classes of exporters who, under typical conditions, would not get credit from international banks or financial markets either because of their country's payments position or because of their lack of banking standing. This is because the facility would separate the credit risk from the country risk and assess creditworthiness on transaction basis. Additionality stems also from the superior access of the facility to financial markets: the à forfait and bond markets. This is relevant to exporters even from the most credit-worthy countries. Such countries can have an additional source of finance without increasing their market exposure. Superior access results from two considerations: the first pertains to the facility's lower aggregate risk, the collective character of its responsibility and the financial drawing ability conferred upon it by its market niche or position. The second consideration pertains to the restricted access of typical developing countries to markets in the wake of the debt crisis of the early 1980s. It is evident that if the principle of severally and collectively responsible membership is built into the facility, its creditworthiness will be better or equal to the most creditworthy of its members. In other words, there will be a Pareto optimality in creditworthiness in that the facility would command a credit rating equal to or higher than that of any of its members.

54. The additionality considerations take on particular importance against the background of the debt crisis. Developing-country access to international markets, banks and bonds has dramatically changed since the early 1980s. The data show that, prior to the debt crisis, these countries received more than $US 80 billion in annual inflows, of which more than $US 25 billion from the syndicated market only. After 1982, regions like Latin America, which had been previously the biggest receivers of external resources, became net negative receivers; Latin America had outflows of some $US 30-35 billion annually up to 1987. In some years (e.g. 1988), developing countries, taken together, have had negative flows (see table 3 in TD/B/1300/Supp.1).

55. To be sure, some developing countries, notably in East Asia, have not experienced such access restrictions as have the heavily indebted countries. But even such countries with viable and continuing access can view the ITFF as an extra source of funds with no impact on their exposure in financial markets. It should be added that some of the most important exporters among developing countries have run into debt problems and suffered in consequence access stoppage in both the syndicated lending, individual bank lending and bond markets. As the consultants state in their report (TD/B/1300/Supp.2), even though bankers distinguish in principle between export credit and general-purpose lending, they have in reality lumped the two together after the debt crisis.

56. Naturally, if developed countries and international institutions and concerns were to join the facility, not only would the capital base be higher but so would the additionality for every dollar of capital subscription. Thus, both the high credit rating countries and the lower credit rating ones would gain financial additionality.

57. There is also a quasi or potential additionality which issues from the stamp of approval effect an ITFF might confer upon a member, especially one of less than the highest credit rating. Association with the facility should enhance a member's credit standing in the eyes of other financial institutions as well as make it possible for its exporters to get a more favourable introduction to other financial institutions. Another aspect of this quasi additionality pertains to participating international commercial banks. The facility has a credit enhancing effect on developing-country debt which can have positive effects on developing-country debt in general and its value in the secondary market.

58. In summmary, a collective, market-based, successful and specialized international institution is a viable means for developing countries to increase their collective access to financial markets and acquire additionality. It offers also an appropriate context for marshalling international cooperation in meeting their trade financing needs. It has additionality for all countries, even those with no debt problems, and credit-enhancement effect regarding international commercial bank business and the value of developing-country debt in the secondary market.

D. Economies of scale

59. The empirical judgement of the consultants who prepared the document on the financial feasibility of the ITFF is that the facility would have scale economies in so far as the cost of information and its quality are concerned. There may be other, though smaller, scale economies for other operating costs, excluding salaries. An important aspect of scale economies is the potential reduction in per dollar asset cost of refinancing when the facility refinances with clearing houses on a wholesale basis large volumes of paper.

E. Cost advantages

60. A successful ITFF would set its charges on cost-plus basis. This would mean uniform standards of commissions for all countries. Another aspect of costs is the rates and commissions charged to the ITFF by the markets. Because of its size, business network gains to its counterparts, and established market relationships, the ITFF would obtain from the markets favourable, big-customer charges and commissions, thereby reducing its per unit funding costs.

F. Market niche

61. An ITFF would be, despite its initial concentration on short-term credit, the only institution whose primary vocation is non-traditional export financing. There are currently no such institutions of developing countries except for BLADEX, the IADB and the IsDB. The first two of these institutions are strictly regional. The third requires a specified membership profile. Because of this vocation, the ITFF would be endowed with all the advantages of specialization, be it in drawing up proper risk assessment, having superior information quality, branching into considerable business networks or providing a meeting forum for potential partners. A contributary factor to market "niches" is the interfacing of the ITFF with its local focal points, which include all the machinery of trade financing in developing countries.

G. Standardization of procedures, papers, rating and legal characteristics

62. An ITFF would produce standardized trade papers which meet international standards, legally and financially. It would apply international procedures and accounting norms in its operations and creditworthiness evaluation. All of this would result in more marketable trade paper with well-known legal and financial characteristics; in other words, more potential negotiability. This would facilitate credit rating and should place it on less arbitrary and ad hoc basis. It would also ease comparability of members' national trade papers since a process of conformability to the same norms and standards would be set in motion in all countries.

H. Auxiliary benefits

63. These benefits encompass information gains not only regarding credit rating and financial information but also regarding trade possibilities and exporter-importer network gains.

64. There are possible spin-off effects in the area of guarantees and export-credit insurance which are a result of standarization, the adoption of common credit-rating norms and the guarantee requirements of the ITFF through its national focal points. This will be detailed in section IV.

65. Another auxiliary gain is possible interregional linkages with payments and clearing arrangements and, in the process, making possible the transferability of trade claims interregionally.

66. Perhaps one of the most important auxiliary benefits is the complementarity of an ITFF with the evolution of the GSTP process (Global System of Trade Preferences among developing countries). The linkages and complementarities between these two are numerous. An ITFF will have to adopt some of the GSTP provisions on eligibility of goods and services for access to its financing. Moreover, the evolution of the GSTP will enlarge the underlying trade among developing countries, thereby increasing the scale economies and risk-pooling gains of the ITFF. It is evident that the GSTP's next phase will, inter alia, call for a more evolved financial and monetary infrastructure among developing countries. An ITFF would be the centrepiece of such an infrastructure. To the extent that an ITFF can evolve healthily, trade access under the GSTP can be further exploited and deepened.

67. In conclusion, a properly designed ITFF is a timely and much needed initiative. It serves the needs of trade evolution and fills an unacceptable institutional and functional void. It has inherent merits of specialization; improved market access; financial additionality; cost and scale-economy gains; spreading and reducing the trade finance risk among developing countries; and, meeting the requisite financing for realizing a larger trade expansion. In addition, it would have considerable spin-off benefits and favourable collateral consequences. These benefits accrue not only to members and exporters from members with less than the highest credit rating but also to members and exporters of high credit-worthiness.

IV. A PROPOSAL FOR AN INTERREGIONAL TRADE FINANCING FACILITY

68. No set of arguments can ensure that an institutional mechanism would indeed produce the expected and desired results. This has to be secured by carefully designing the characteristics and features of such an institution.

69. The Committee on Economic Cooperation among Developing Countries, in its resolution 4 (V), stipulated that the feasibility of an ITFF be assessed in the context of market and financial viability. The consultants' study (TD/B/1300/Supp.2) details a proposal which turns out to be viable on these criteria under a wide variety of scenarios it sets forth. In what follows, the salient features of this proposal are outlined and some important aspects of it are developed.

A. Outline of the proposed facility

70. The proposed facility would be an institution operating on a commercial basis, with assets consisting of short-, medium- and long-term loans. Its liabilities would consist of funds borrowed from financial markets, term deposits left with it and capital subscribed by its members, including governments, public and private institutions and the participating multilateral funding institutions. The proposed facility offers primary trade finance to exporters from developing countries. The exports involved should meet certain agreed standards of origin and other strictures of acceptability. The credit applications first pass through local focal points set up as counterparties in agreement with participating members. The local focal points do initial credit checking of the exporter and his bank. They apply in their task agreed norms and standards of credit evaluation and eligibility of goods. Once this initial phase has passed, the applications are taken up by the facility for credit evaluation and processing. The facility limits access to a certain level based on a member's total subscriptions (official and private). These limits are revised periodically in relation to the progress of the facility in its leverage and its access to secondary finance.

71. The facility does not issue guarantees of its own. In cases of applicants of less than the highest credit rating, it may demand guarantees in some form from the exporter. But this can be relaxed at the discretion of the facility when warranted.

72. The facility grants credit on short and medium terms, with the mix between these two changing over time as it establishes a track-record for itself. While the eventual primary vocation of the facility will be the financing of non-traditional exports, as defined by its internal protocols, it will start operation with a heavy preference for short-term credit but shift gradually to medium-term maturities. It may also finance initially exports from developing countries to any destination. 10/ The facility will avoid bearing foreign-exchange risks through a variety of techniques and/or agreements with relevant central banks. All the operations are channelled, at least initially, through a single window.

73. The facility would strive, depending on its membership credit standing and the structure of its capital, to refinance, on its own responsibility, its

assets in the international markets, including the bond and the à forfait markets. It would also use these markets, especially the latter, for realigning its maturity structure and managing its liquidity.

74. The facility would price its charges and various commissions on a cost-plus basis. Its operating principle is to cover its costs and except for retained earnings to pass any surplus to its users in the form of reduced charges.

75. In co-operation with its network of "local focal points", the facility would maintain computerized data covering credit information, trade opportunities, information on traders and marketing facilities, as well as any other information deemed useful. It places such information at the disposal of its members and users. It would also provide, without responsibility, introduction and network services to its users as regards financial institutions and potential counterparts of trade. Furthermore, the facility deals directly with local trade-finance institutions and regional clearing and payments arrangements, facilitating and promoting in the process their cooperation and linkages. It may extend, as appropriate, whatever technical assistance it deems feasible. The facility promotes standardization of norms, papers and legal forms in accordance with international standards.

B. Commercial viability

76. As set forth by the consultants, commercial viability is considered against a background of three empirical assumptions, namely: the ITFF will have a relatively small capital base initially, both in the amount of capital subscription and the credit-rating of the initial membership; the ITFF will operate on higher gearing ratios than development finance institutions; the ITFF is likely to have a shortage of guarantee coverage initially, and the status of its credit rating will be modest at its inception.

77. In view of these judgements, market viability will be based more on the quality of the ITFF portfolio than merely on the capital base. However, if developed countries and multilateral financial institutions and international concerns join in, the importance of the capital base and membership backing relative to the portfolio would increase. Since commercial viability implies sustainable funding, an operational definition can be stated in terms of design characteristics and an operational record that would permit the ITFF to pay high enough for funds that it can compete for and attract from the bond market, but low enough to enable it to clear a profit over its costs. In addition to profitability and self-sustenance, viability can also be extended to include a notion of usefulness to members, i.e. making a difference in trade-financing availability. On the shorter definition, financial viability can be demonstrated by rates of return under reasonable operational assumptions. On the extended definition, commercial viability would be added to a qualitative evaluation of the scope of operations, nature of business and coverage of members. Both of these dimensions will be pursued in this report.

C. Scope of operation and country coverage

78. Although the market niche of an ITFF rests upon providing financing for non-traditional exports, calling for medium- to long-term export financing, initially viability would require a portfolio with short-term financing. After the ITFF establishes a track-record, it can shift more and more to medium-term financing. However, a viable ITFF should not abandon all short-term financing lest it run two risks: the risk of being too different from other institutions and that of covering exports of too few countries. A good operational criterion would be to restrict the facility's operations to developing-country export financing, with medium-term financing extended to more credit-worthy countries and short-term finance to less credit-worthy countries. However, it should in all cases accept business on transaction criteria, i.e. estimated credit risk on transaction basis. Under the scenarios developed by the consultants, the ITFF should aim at reaching a volume of business between $1.4 billion and $7.9 billion annually within five years of its inception. This corresponds to a range of between 11 and 86 per cent of the annual needs, or shortfalls, of the underlying financial needs for trade in non-traditional products.

79. The Committee's resolution 4 (V) places emphasis on non-traditional exports of goods and services. No doubt the rationale is that traditional exports have other alternative financing sources, that their risk does not require spreading among members and finally, that medium-term financing of non-traditional exports requires specialization. The proposal set forth here discards a strict product-based definition of non-traditional exports in favour of one which, in addition, involves country and market-based criteria. Moreover, under current market conditions, expert view points to the fact that even traditional exporters are now forced into extending medium-term loans. 11/ On this measure, a new export or an export to a new market is considered non-traditional by the proposed facility even if it does not fit the product-based definition. It should be recalled that the latter defines non-traditional exports as capital goods and services plus other manufactures, i.e. in terms of the Standard International Trade Classification (SITC).

80. There is a pragmatic justification in this non-product-strict definition. First, it meets an equity criterion among countries and, in distributing the ITFF benefits, secondly, it extends the benefits of the facility to a large number of developing countries, enhancing thereby its "political viability". Nevertheless, this a matter best left for political negotiations.

D. Risk management

81. The facility is exposed to the following risks: credit risk, country risk, funding and maturity risks, and foreign-exchange risk. It is proposed that the facility should minimize its credit risk by creating local "focal points" with requirements of effective evaluation and guarantor process and limits to country drawings. The ITFF should always accept country risk within country limits when the credit risk is acceptable. The role of guarantees, local focal points and standardized credit evaluation procedures on this score is of critical importance. To reduce maturity risk, the portfolio should hold a portion of assets in short-term and move out to medium-term gradually and in relation to its success in getting bond financing from the international markets. The facility should not venture into shouldering foreign-exchange

risk by restricting itself to dealing in hard currencies. 12/ To reduce its funding risk, the ITFF should strive to match the maturities of its assets and liabilities as closely as possible (cf. TD/B/1300/Supp.1, sect. III).

E. Guarantees and insurance

82. The guiding principle here is for the ITFF not to issue any "own guarantees" and to use guarantees or insurance cover to enhance its assets quality. As to guarantees on its bond obligations, the matter is bound up with whether or not the ITFF will have callable capital and whether or not multilateral funding institution would guarantee its obligations.

83. It is recommended that the ITFF seek guarantees from central banks and commercial banks for loans it makes. The local focal points would certify to the quality of commercial banks (or other alternatives) according to standarized criteria. Guarantees would be required from countries with less than the highest credit rating but not from those with, say, A-rating. Furthermore, country limits may be made extendable depending on guarantees. This furnishes an incentive and assures equity. For those that are unable to furnish guarantees, but which in all other respects meet the "local focal point" standards, rationing within the country limit might be practised depending on the funding position of the facility. Obviously, it is not proposed here to adjust charges in relation to the availability of guarantees.

84. The value of guarantees should not be exaggerated. They are only as good as the guarantor; the signature of an indebted country or unknown commercial bank would hardly enhance the asset in question.

85. The importance of guarantees is to establish "acceptability" of the portfolio asset and/or "negotiability" of the instrument involved. In the first case the guarantee enhances the portfolio quality and improves the facility's access to the bond market while, in the second case, the guarantee improves access to the à forfait market. The form of the guarantee por aval, by means of a guarantee agreement, or under a letter of credit would not matter for it makes no risk difference.

86. If a comprehensive international system of guarantees is set in place, some might consider it as an alternative to an ITFF. However, there are several considerations involved and this matter is addressed in section V below. The issue of guarantees is tied up with whether the facility has or does not have a callable capital. The consultants give a market assessment of "callable capital" to the effect that it is not of much help. However, if developed countries were to join the facility, the importance of the callable capital would increase in relation to the paid-in capital. A related point is whether multilateral institutions would join and, in particular, guarantee bond obligations of the ITFF. That, of course, would make a fundamental difference. But in the past, these institutions have not been in favour of engaging their resources, on a one-to-one gearing ratio, in guarantees. To be sure, a dollar loan or a dollar guarantee on the basis of a one-to-one gearing ratio would pose the dilemma of whether to lend or to guarantee. But if functional utility and diversification is to be considered, the issue would not be one of lending or guaranteeing, but one of doing some lending plus some guaranteeing. Since, in practice, these institutions are not always loaned

out, the issue of guaranteeing bond obligations can be viewed entirely on pragmatic feasiblity grounds rather than on the basis of trade-offs which are only relevant in theory.

F. Types of facilities and financing

87. The analysis here relates to the discussion under sections A and C above. It is suggested that finance be extended to both exporters and importers. Initially, and for considerations of risk management and portfolio quality, the operating principle should be that a transaction should involve an export from a developing country. As to whether or not transactions should involve only non-traditional exports, the question has already been covered in section C above. The same is also true for short-term versus medium-term finance. Lastly, local focal points would give preference initially to better-standing counter parties. Gradually this should be relaxed. The ITFF should extend both pre- and post-shipment finance as necessary.

88. The structure of the facilities offered should in principle correspond to functional finance differences. However, since the ITFF is projected to evolve over time and provide initially both short- and long-term finance to both exporters and importers, it is recommended that there should be one general account facility.

89. The general account facility would charge commercial rates on a cost-plus basis. If in the future a subsidy window is to be created, it should have an altogether separate account, which implies independent resources and procedures. In this connection, it should be recalled that subsidies exist in most export financing. It is possible that equity considerations might shed a different light on this matter than do considerations of pure economic efficiency. Moreover, developed countries might want to use a subsidy account to blend aid elements with export finance. The question, within the stricture of separability, should be left to negotiations.

G. Capitalization

90. The amount of capital depends on the mix of finance, the degree of leveraging and the facility's access to the international financial markets. The consultants' study (TD/B/1300/Misc.2) presents a financial feasibility analysis on two capital-base options: a low level of $US 300 million and a high-level of $US 750 million. The study points out that any capital figure can be used as an alternative. To facilitate consideration of alternatives, it provides sensitivity analysis gauging the implications of a change of $US 100 million in the capital base.

91. A more rigid approach to capitalization such as capitalizing the facility on the basis of financial needs or short-fall estimates would have only superficial objectivity; most such projections offer spurious precision. In any event, the size of the capital base depends on what participants decide they can and would contribute.

92. It is recommended that the proposed ITFF have five classes of members and capital subscribers: developing-country governments (including central

banks); developing-country firms and banks; developed-country governments; international official insitutions; and international banks and other finance concerns. This is along the lines of the BLADEX model.

93. As regards paid-in versus callable capital touched upon before, the facility should be capitalized on the basis of a certain threshold level all paid-in. If developed countries and international concerns join in, callable capital would become important in securing access to financial markets and hence mobilizing secondary finance. Otherwise, callable capital from developing countries only would not be considered important by financial markets. There is, of course, an implicit trade-off between the size of the paid-in capital and the callable-capital if the latter is instated. This trade-off would arise if developed countries and international institutions were to join the facility and this would in consequence raise the issue of the gearing ratio. In other words, if developed countries join, then it would be possible to reduce the low-case capitalization to less than $US 300 million but create a callable capital to underpin borrowings and performance.

H. Asset and liquidity management

94. Under this rubric two apsects are dealt with: leveraging and the use of the à forfait market. 13/ The consultants, basing themselves on market comparisons, suggest a leveraging ratio between 5:1 and 10:1. This is midway between the multilateral development finance (MDF) institutions which operate on 1:1 ratio and commercial banks which use up to 20:1. However, in the case of the MDF institutions, the credit risk is considerably higher than the export-credit risk. Moreover, because the multinational financial development institutions (MFDIs) have callable capital, the 1:1 leveraging does not imply the same qualitative relationship to paid-in capital. 14/

95. The à forfait market would be very interesting and important to the ITFF. It will offer secondary financing via refinancing the ITFF assets. It would also enable the facility's management to adjust the portfolio composition and minimize the various funding maturities and credit risks. Moreover, it makes it possible to unbundle short-term from medium-term components, enabling the ITFF in the process to increase its medium-term lending.

I. Financial feasibility analysis

96. To evaluate the feasibility of the proposed ITFF in the light of the specific design characteristics and attributes outlined above, simulations were performed on the basis of a base capital involving high and low cases and a certain set of assumptions. All in all, 10 scenarios were simulated to show the results of changes in the key variables under both the high and low capital bases. The annex to TD/B/1300/Supp.2 documents these simulations. To be sure, the generated scenarios do not exhaust all the possibilities. However, they depict a range of outcomes which, taken together, give a sense of the realistic possibilities open. Recourse to sensitivity analysis was undertaken to depict the robustness of the assumptions and aid the Board and experts in envisaging a range of alternatives and configurations to the proposal. The remainder of this section sets forth the assumptions of key parameters, then presents the results and finally evaluates the outcomes.

Assumptions and scenarios

97. The range of assumptions detailed below are formulated on the basis of market views of practitioners. In other words, they have been filtered through market judgements about their reasonableness and appropriateness.

(i) Capitalization: The base case assumes first a low capitalization of $300 million - a minimum threshold. This would be paid in three instalments at the beginning of the first, third and fifth years. The high capitalization case is set at $750 million, with similar phasing. To allow for flexibility and to trace the sensitivity of capital increase, the impact on the operations of an increase of $100 million in the capital base is calculated and described in the analysis. The pattern of effect starts in the first year and doubles the value of assets in the first two years. Thereafter, more increments are allowed for and a pattern of diminished effects appears as the increments work their way into the operations.

(ii) Leverage: A phased increase in leverage is built into the analysis over the first five years. The leverage is assumed to reach 1:2 against the base capital as defined by paid-in capital plus reserves and retained earnings at the end of the first year. Leverage moves up to 3:1 at the end of the second year, 4:1 at the end of the third year and 5:1 at the end of the fourth and fifth years;

The leverage parameter is changed for the purposes of sensitivity analysis to a 10:1 target over the same time period at the same relative phasing. The market judges 5:1 as "quite conservative", while a 10:1 is judged as "rather aggressive". 15/

(iii) Liquidity: Liquidity reserves, in time-deposits and other money-market instruments, are scaled at 12 per cent of total earning assets in the base case. This is changed to 10 per cent for the sensitivity analysis.

(iv) Maturity structure: For the base case, 95 per cent of the financing was placed in short-term assets and 5 per cent in medium-term initially. Then this was shifted to 75 per cent and 25 per cent respectively to depict sensitivity impacts, except for scenarios 9 and 10 where an even distribution was assumed.

(v) Risk profile: This profile interacts with the maturity structure in that riskier, i.e. less creditworthy countries, are steered to short-term lending while higher creditworthy countries are favoured for medium-term lending. For the base case, short-term assets are allocated at 50 per cent to class-A risk countries, 30 per cent to class-B risk countries and 20 per cent to class-C countries, whereas medium-term assets are allocated at 75 per cent to class-A countries and 25 per cent to class-B countries. It should be pointed out, in this connection, that risk classification is rather subjective and is usually formulated by markets on the basis of the prevailing perceptions. The position of a particular country in the lists certainly changes from period to period. What is relevant is the

categorization as such and not which country or countries are in which category. Since markets do rate in categories, the use of such benchmarks for generating the scenarios is unavoidable. For the purposes of sensitivity analysis, an even distribution of lending was assumed instead of the above-mentioned distribution.

(vi) Interest charges and earnings: The parameters are here expressed in relation to a LIBOR set at 8 per cent in the base case. The interest charge is a margin above LIBOR which varies with the credit rating of the borrower. For purposes of sensitivity analysis, all spreads were lowered, i.e. margins above LIBOR were reduced.

(vii) Other assumptions: These include overhead costs and their multiplier effect per employee; loan-losses; dividends and taxes at the United States rates.

98. In addition to the scenarios generated by the assumptions and their modifications, scenarios were also constructed for the joint impact of greater medium-term lending with an even allocation among various classes of countries. To round off these scenarios, a problem case was considered whereby there is a greater concentration on medium-term lending, a more even lending among borrowing countries and less spreads of charges in each case than allowed by the assumptions. This should represent quite a liberal ITFF. A summary of the scenarios is annexed to this report.

J. Results and evaluation

99. Before stating the results, it should be recalled that the base case, though realistic, is quite modest. And the ranges allowed in the sensitivity analysis do not, except for leverage, qualify as agressive. Moreover, the market perception of the ITFF is rooted in an image of a developing-country institution with no callable capital. As it will be argued in the last section of this report, this perception would change if developed countries were to join the facility.

100. Furthermore, the perception of developing-country risk is conditioned by the persistence of the debt problem in 1991. A change in the debt situation, a more favourable external environment for development or a more forthcoming attitude by the developed countries would all modify judgement as to the reasonableness of the assumptions and the configuration of the scenarios. In particular, this would affect the risk and maturity profiles of the ITFF and the accrual of benefits to the less creditworthy countries. In sum, a more favourable market perception in consequence of such changes would allow for a more liberal ITFF.

101. The general results demonstrate that the proposed facility is financially viable on market criteria. In particular, it is profitable under all scenarios, including the problem one. In the fifth year, the after-tax rate of return on capital is 3.9 per cent in the problem scenario - scenario 10 - at the low end, and 9.3 per cent in scenario 9, the high-capital one. 16/ Returns on total assets/forfait range between 1.0 per cent in scenario 1 to 2.5 per cent in scenario 9. This compares well with the IBRD figures of 1.1 per cent and 1.8 per cent in the past five years. Finally, the annual

volume of financing extended to developing countries would range from $US 1.4 billion in the low-capitalization case to $US 7.9 billion in the high-capitalization one. The interested reader is referred to the consultant paper (TD/B/1300/Supp.2) for the detailed calculations.

102. Evaluating these results, the following comments are in order:

(i) With the qualifications set forth at the head of this subsection and amplified further in section V of this report, the proposed facility is viable under all reasonable assumptions and on both definitions of viability;

(ii) Increasing the capital base would augment the credit volume more than proportionately, because of the interactive nature of risk, maturity and the phasing of the leverage;

(iii) In the high capital base case, the rates of return on capital and total assets are quite high and compare with similar returns on investment-grade enterprises;

(iv) The direct benefits to developing countries, as approximated by the volume of finance extended, is appreciable. In the high-capital case, it is more than double the relative difference in capital (high case to low case). When indirect benefits in the form of additionality to low-credit-status countries, standardization benefits, association benefits, information and network gains and potential cost savings are all added, the proposal assumes added merit and enhanced viability. Indeed the tabulated figures would be correspondingly understating the benefits;

(v) Once it is a "going-concern", the facility will climb up the financial ladder and will establish a credit standing and performance record that would liberalize its access, decrease its costs and increase the volume of its benefits beyond what the scenarios here show or could reasonably postulate at this time. In other words, market assessment at this juncture is adversely influenced by a pessimistic perception of developing countries and this makes for a rather conservative view in constructing the scenarios.

V. RELATED ISSUES

A. Action-list recommendations on developing-country financial infrastructure

103. The review undertaken in the secretariat's supplementary report (TD/B/1300/Supp.1), together with comparable experience in developing countries, leads to conclusions and recommendations as to what developing countries might do, each on its own, to bring more efficacy to national trade-financing schemes. To be specific, the following recommendations might be put forward for consideration.

(a) Trade credits

(i) To ensure that export credit flows remain at levels broadly appropriate to the capacities of South-South trade, and that abrupt changes in availability do not occur in a manner that is damaging to inter-developing-country trade;

(ii) To ensure that trade-related credits are used effectively in a way that protects the position of creditors and helps to avoid repetition of the widespread losses suffered by commercial banks of a number of developing countries.

104. The task facing the monetary authorities or central banks should lead, inter alia, to the adoption of the following policy measures:

(i) Lending to the export sector should be given a separate consideration within the overall monetary policy of the central banks by having specific sub-targets for it. This should be negotiated with IMF in all stabilization programmes. In addition, foreign exchange for the import inputs needed for export production should be allocated on a priority basis to the most efficient and dynamic sectors as they are an important source of foreign-exchange earnings;

(ii) Expand the ability of exporters to extend credit to foreign buyers, through the establishment of refinancing and guarantee facilities. In this connection, the establishment of insurance and guarantee schemes - whether private, public or jointly owned by the two sectors - would greatly enhance exporters' access to refinance;

(iii) Administrative procedures for import and export licences should be made, short and simple. They should employ standardized forms and have a "sun-set" provision on the time for processing applications and accessing to credit. In addition, if central banks have to be involved, they should set up a separate department for export credits organized in all respects like export credit institutions and staffed with specialists in the field.

(iv) Developing countries which lack an efficient and adequate banking system should consider introducing reforms in the banking regulations and supervision, ownership restrictions and office branch franchising;

(v) Remove prior central bank authorization for transactions involving working capital credits, particularly those involving imports of inputs required for export production;

(vi) Establish a forum, including seminars and workshops, for direct dialogue with exporters and other operators in order to exchange views and receive feedback on the efficiency and the performance of the institutional set-up.

(b) National export credit insurance and guarantee schemes

105. The establishment of national credit insurance institutions naturally raises many policy issues. The most relevant for our purpose may be the following:

(i) In view of the potential volume of exports, particularly of manufactures and semi-manufactures, insurance and guarantee schemes should provide a priori a sufficient premium income to make such an institution viable, at least in the medium to long run. Such schemes may be established either as public or private institutions, or under joint ownership.

(ii) Since the proper functioning of such institutions requires highly qualified and competent managers, provision ought to be made to train the requisite cadres.

(iii) Given the multiplicity of new destinations and new traders, adequate credit information should be made accessible to exporters through, for example, exporters' associations or chambers of commerce. This would greatly reduce the costs of risk evaluation. In effect, this amounts to creating organs along the lines of the "focal points" proposed here.

(iv) Insurance and guarantee schemes should be provided for the provision of pre-shipment finance to manufacturers/exporters. In this case, official support is urgently needed in most developing countries as commercial sources appear to be underdeveloped.

106. In conclusion, while premium income may be inadequate because trade is small, trade is small partly because credit risks cannot be insured. It is necessary to break out of this circle.

107. There are also some steps that can be taken by developing countries which, while a part of the ITFF proposal, can be valuable on their own and be effected prior to setting up the ITFF. These include setting up uniform credit evaluation standards for export finance, setting up information focal points, adopting international common accounting and legal forms and cooperation on rating trade finance paper.

B. International export guarantee facilities

108. As the secretariat report and the supplementary document based on it found, there are very few - i.e. eight - export guarantee and/or export credit insurance schemes in developing countries. For securing insurance and/or guarantees, developing countries in their overwhelming majority have to seek specialized international facilities. This is both costly and once again passes through an individual credit evaluation process with credit and country risks combined. The hurdles therein are just as formidable as in obtaining primary international finance.

109. As was pointed out earlier in this report, guarantees improve access to markets and, in particular, open up the à forfait and bond markets for developing-country export credit paper. In other words, they make possible refinancing from international sources. The idea of international cooperation on the guarantee issue has been brought up in several forums, including the UNCTAD forum. 17/ International cooperation on this score entails spreading the risk of export credit - a very important consideration in medium-term finance - improving the credit standing of the primary finance paper involved and, ceteris paribus, until the guarantee is invoked, reducing both the cost and capital required for coverage. The establishment of a guarantee mechanism would aim primarily at opening up secondary markets, i.e. at securing secondary financing. Hence, it would have a leveraging effect on every dollar raised for primary financing. It would follow then that it may be a substitute for an ITFF only if all developing countries have access to primary financing either from their own resources or from regional/subregional primary finance institutions. 18/

110. In the context of the proposed ITFF, the existence of a net of international guarantees would improve greatly its efficacy, increase its leverage and reduce the pressure to enlarge its capital base. In other words, it implies some trade-off with the requisite size of the capital threshold. But such a net neither exists now nor is currently being proposed anywhere. As a case in point, the Charter of the World Bank MIGA would have to be revised, and its capital base increased, if it were to enter into export guarantees.

111. International cooperation on the guarantee front would be extremely useful if the multilateral development organizations were to guarantee the bond issues of the proposed ITFF or if developed countries were to join the ITFF, especially in regard to callable capital. That would then place a guarantee behind all the operations of the facility in the international financial markets.

C. Membership and participation of developed countries

112. The participation of developed countries would not only enlarge the capital base of the facility but, perhaps more importantly, would underpin its credit rating and greatly enhance its perception by markets. It could further encourage international banks to join in, not to mention the probable participation of the multilateral development organizations, which are controlled by these countries.

113. It has been pointed out throughout this report that developed-country membership represents a qualitative transformation in several areas. Such areas would include, above all, the need for guarantees, the size of initial paid-in capital, access to financial markets by the ITFF early on, and hence mobilization of secondary resources. It would also enable the facility to leverage its operations at a faster rate. Additionally, the joining of developed countries would alter the rationale behind not having callable capital in the proposal put forward in this report. Callable capital, when developed countries are members, would become meaningful in all borrowings and funding operations by the facility in the international markets. This would reduce the threshold paid-in capital. It is for these reasons that the proposed scope of membership covers, in a manner similar to that of the BLADEX, members other than developing countries and their institutions. Even subscription by developed countries to the callable capital only would be a momentous contribution.

D. Institutional aspects

114. The brief discussion here is intended only to build into the structure the commercial and non-political orientation of the ITFF. Hence, while representative of the membership, management of the ITFF should still be independent in decision-making. Perhaps these two aspects can be given expression by creating layers of management with different functions and purposes. For example, democratic participation might be expressed in a Governing Board representing all the members, while representative management might be expressed in another Board, say an Executive Board, based on constituencies. The Governing Board would have only overall directional prerogatives and would be a parliamentary body which meets infrequently, while the Executive Board would represent constituencies, meet frequently and supervise operations. The constituencies would be related to capital shares whose formula would have a multi-faceted character as will be discussed hereafter. This two-tier control combines the imperatives of democracy, representativity and sound management. The staff of the ITFF should be selected strictly on merit: qualifications and experience and not political patronage.

E. Capital shares and membership classes

115. Multiple criteria should be devised so as to combine measures of benefit, ability to pay, liquidity capacity, and voluntarism in setting participation shares. These, in turn, would determine drawings, voting and participation. While the first three are self-evident, voluntarism is included for developed-country members and international participants, as well as for regional development banks. However, two qualifications are in order: (i) no country should have a veto power by itself; and, (ii) certain qualified majorities ought to be stipulated for certain types of decisions. It would not be advisable to distinguish between classes of members beyond what is built into the participation formula.

116. A certain number of countries and institutions would be necessary in order to attain a viability threshold for establishing the ITFF. The consultants provide, in section VI of TD/B/1300/Supp.2, an illustrative suggestion.

F. The role of local focal points

117. A novel and interesting feature of this proposal are local focal points. They do several things: they channel contacts with local exporters, banks and authorities; they accomplish the first-round processing of applications, performing such tasks as checking credit rating of exporters (importers) and their banks; and ascertain that all the documentation, rules of coverage and other statutary requirements are met. In all of these functions, local focal points are pure intermediaries which work on commission and assume no legal guarantee responsibility. Since they collect information and disseminate it, they are natural candidates for maintaining data banks. In sum, they are essential links in a coordinated chain which brings about standardization of instruments, papers and procedures. 19/

G. Rating of export credit paper and standardization

118. An interesting by-product of the ITFF would be its "standardization effect". This is manifest in various ways and at various points in the credit extension process. First of all, the procedures, generated papers and instruments would be uniform throughout. Secondly, they would conform to international norms and standards of accounting, credit examination and legal drafting. Thirdly, the ITFF would devise marketable instruments negotiable in all markets. Fourthly, through its local focal points, the ITFF would build a data bank of trade and credit information. As a result of all of these, the ITFF will make it possible and relatively easy to bring about a uniform and widely acceptable system of rating of developing countries' export credits.

Notes

1/ The consideration of this item was postponed to the thirty-eighth session of the Trade and Development Board.

2/ Algeria, Argentina, Bangladesh, Barbados, Benin, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Egypt, Ghana, Honduras, Hong Kong, Indonesia, Iraq, Jamaica, Jordan, Kuwait, Malawi, Malaysia, Mexico, Morocco, Nigeria, Peru, Philippines, Republic of Korea, Saudi Arabia, Senegal, Sri Lanka, Thailand, Tunisia, Turkey, Uruguay, Venezuela, Yugoslavia; African Development Bank, Andean Development Corporation, Arab Monetary Fund, Asian Development Bank, the Banco Latinoamericano de Exportaciones, (BLADEX), Caribbean Development Bank, Central American Integration Bank, Ecobank, Inter-American Development Bank, Islamic Development Bank.

3/ Non-traditional exports consist of products classified as capital plant and equipment plus some manufactures. This product-based definition, however, is not satisfactory for all countries. Many commentators consider new exports or exports to new markets as "non-traditional". Moreover, when looked at from the credit side, even traditional exports, on the product-based definition, have been calling for non short-term credit.

4/ The term "buyer credit" is usually used to refer to credit extended by the seller or arranged by him (through banks) to his importer. Perhaps the term "seller-credit" would be a more accurate one.

5/ Even traditional exporters sometimes need pre-shipment credit. An example was cited by a Sri Lankan tea exporter who reported that he needs pre-shipment credit to buy the tea before exporting it.

6/ This is done mainly through confirmed letters of credit.

7/ Throughout this report the terms "trade financing" and "export credit" connote different degrees of inclusion. The term "trade-financing" involves credit extended to exporters and buyer credit extended to importers as well, whereas the term "export credit" refers only to credit extended to exporters.

8/ There are of course lags in the impact of growth of trade on the availability of savings. The fact that there are shortages in the volume of savings at a point in time does not render the statement of the text valid only ex post. It is valid ex ante to the extent that the ex ante trend in the use of savings still relegates export finance to the station of a secondary preference. Moreover, the empirical evidence on the length of the income-multiplier lag is such that the shortage is in effect within each period.

9/ It is quite evident on standard economic grounds that there is no reason to expect that the market mechanism will necessarily function efficiently if sub-optimality of production, trade or finance is in effect. The institutional underdevelopment would then clearly indicate a case of "market failure".

10/ This suggestion is put forward by the consultants. There are merits to this criterion of export source. The question is at heart empirical: how much intra-developing-country trade credit is compatible initially with a good portfolio quality. It is also a political question in that the facility should be useful to a broad membership from developing countries covering a wide range of levels of development.

11/ This was the consensus view of the expert group meeting convened by the Secretary-General of UNCTAD to advise him on this subject, which met in Geneva 11-12 July 1991.

12/ The proposal set forth in this section follows the consultants' recommendation (cf. TD/B/1300/Supp.2) that dealing with the one hard currency or currencies would avoid foreign-exchange risk. This is true in principle but not very meaningful in all cases and under all the circumstances. In particular, two factual configurations might call for discarding this principle. The first is when importing countries, on balance, demand a currency not designated by the ITFF as a vehicle but available from a net exporter. The second situation arises if a basket of currencies would yield superior results than the one or more designated currencies. These are illustrative factual configurations that show that avoiding the foreign-exchange risk might not necessarily involve dealing with one or more specific currencies all the time. Another technique is back-to-back contracting in the same currency. It remains true that as long as the

exporter would face a hard-currency obligation, when his revenues are not all in hard-currencies, there is a foreign-exchange risk to bear. The facility can only devise techniques to shift such risk away from itself.

13/ Leveraging is the ratio of assets to paid-in capital plus reserves and retained earnings.

14/ See paragraph 97 (ii) below. The MFDIs operate on a long-term basis in projects for which the social rate of return is a considerable portion of their total return. This non-quantifiable, non-private component poses a higher risk than shorter-term, more or less self-liquidating trade credit. The recent trend towards policy-based lending is even riskier than old project lending.

15/ Empirical judgements might differ as to the viability of leveraging above 1:1. It would seem that several considerations might shape such judgements. The first pertains to a comparative evaluation of development finance risk as compared to trade-finance risk. This report argues that the latter is less than the former. The second consideration revolves around the factors that determine the quality of the portfolio such as guarantees, repayments, maturity structure and risk management. Any judgement in this respect is no more than an informed guess. The jury will only return judgement after the facility establishes some record. The third consideration pertains to the seriousness of shareholders and management about commitment to the facility; in particular, commitment of capital resources by the official and non-official shareholders in developing and developed countries. None the less, a reduction in the gearing ratio to less than 5:1, say to 3:1, should not change in any essential way the financial viability of the proposal; it would simply make for a more conservatively run and conceived facility.

16/ The high rates of return are undoubtedly the result of the rather conservative disposition of markets towards developing countries at this time. A more favourable disposition would lead to a more liberal ITFF with lower rates of return on its assets.

17/ Intergovernmental Group of Experts on the Establishment of an Export Credit Guarantee Facility, held in Geneva, 13 July 1981 and Committee on Invisibles and Financing related to Trade, ninth session, first part, Geneva, July 1980.

18/ Guarantee schemes would go into areas outside the scope of trade finance, such as insuring political and performance risk. If they are designed for broader purposes, they can extend to investment.

19/ The local focal points make it possible to introduce chambers of commerce into their work. In some developing countries these chambers are the only repositories of what traders, banks and commercial practice have evolved as acceptable norms and legal definitions.

ANNEX

SUMMARY OF INDIVIDUAL SCENARIO RESULTS

Base Case (year 5)

Total assets/forfait	US$ 1.57 billion
Net income	US$ 25.5 million
Total capital	US$ 380.4 million
Return on total capital	6.7 per cent
Return on total earning assets/forfait	1.6 per cent

(Note that "Total assets/forfait" is equivalent to the total annual volume of financing.)

Since the base case assumes low capitalization, we compare the base case to the low-capitalization versions of the scenarios:

Scenario 1 : Greater Leverage (year 5)

Total assets/forfait	US$ 3.18 billion
Net income	US$ 31.6 million
Total capital	US$ 395.0 million
Return on total capital	8.0 per cent
Return on total earning assets/forfait	1.0 per cent

Scenario 2 : Less Liquidity (year 5)

Total assets/forfait	US$ 1.90 billion
Net income	US$ 27.4 million
Total capital	US$ 385.7 million
Return on total capital	7.1 per cent
Return on total earning assets/forfait	1.4 per cent

Scenario 3 : Greater Medium-Term Lending (year 5)

Total assets/forfait	US$ 1.59 billion
Net income	US$ 31.0 million
Total capital	US$ 392.0 million
Return on total capital	7.9 per cent
Return on total earning assets/forfait	1.9 per cent

Scenario 4 : Greater Share of Loans to Riskier Country Classes (year 5)

Total assets/forfait	US$ 1.55 billion
Net income	US$ 32.3 million
Total capital	US$ 404.3 million
Return on total capital	8.0 per cent
Return on total earning assets/forfait	2.1 per cent

Scenario 5 : Lower Spreads on Loans (year 5)

Total assets/forfait	US$ 1.48 billion
Net income	US$ 14.5 million
Total capital	US$ 348.9 million
Return on total capital	4.1 per cent
Return on total earning assets/forfait	1.0 per cent

Scenario 6 : Greater Use of the A Forfait Market (year 5)

Total assets/forfait	US$ 1.81 billion
Net income	US$ 24.5 million
Total capital	US$ 376.2 million
Return on total capital	6.5 per cent
Return on total earning assets/forfait	1.4 per cent

Scenario 7 : Higher LIBOR (year 5)

Total assets/forfait	US$ 1.71 billion
Net income	US$ 36.8 million
Total capital	US$ 416.3 million
Return on total capital	8.9 per cent
Return on total earning assets/forfait	2.1 per cent

Scenario 8 : Greater Loan Losses (year 5)

Total assets/forfait	US$ 1.55 billion
Net income	US$ 22.7 million
Total capital	US$ 376.5 million
Return on total capital	6.0 per cent
Return on total earning assets/forfait	1.5 per cent

Scenario 9 : Longer Maturities and Greater Risk (year 5)

Total assets/forfait	US$ 1.59 billion
Net income	US$ 38.8 million
Total capital	US$ 419.1 million
Return on total capital	9.3 per cent
Return on total earning assets/forfait	2.4 per cent

Scenario 10 : Problem Case (year 5)

Total assets/forfait	US$ 1.41 billion
Net income	US$ 13.7 million
Total capital	US$ 355.6 million
Return on total capital	3.9 per cent
Return on total earning assets/forfait	1.0 per cent

All of these scenarios are projected for high capitalization as well as low capitalization. Comparing the two versions of each scenario gives the following results:

Scenario 1 : Greater Leverage (year 5)

Low capitalization

Total assets/forfait	US$ 3.18 billion
Net income	US$ 31.6 million
Total capital	US$ 395.0 million
Return on total capital	8.0 per cent
Return on total earning assets/forfait	1.0 per cent

High capitalization:

Total assets/forfait	US$ 7.97 billion
Net income	US$ 80.0 million
Total capital	US$ 992.8 million
Return on total capital	8.1 per cent
Return on total earning assets/forfait	1.0 per cent

Scenario 2 : Less Liquidity (year 5)

Low capitalization

Total assets/forfait	US$	1.90	billion
Net income	US$	27.4	million
Total capital	US$	385.7	million
Return on total capital	7.1	per cent	
Return on total earning assets/forfait	1.4	per cent	

High capitalization:

Total assets/forfait	US$	4.75	billion
Net income	US$	69.6	million
Total capital	US$	968.7	million
Return on total capital	7.2	per cent	
Return on total earning assets/forfait	1.5	per cent	

Scenario 3 : Greater Medium-Term Lending (year 5)

Low capitalization

Total assets/forfait	US$	1.59	billion
Net income	US$	31.0	million
Total capital	US$	392.0	million
Return on total capital	7.9	per cent	
Return on total earning assets/forfait	1.9	per cent	

High capitalization:

Total assets/forfait	US$	3.99	billion
Net income	US$	78.5	million
Total capital	US$	984.5	million
Return on total capital	8.0	per cent	
Return on total earning assets/forfait	2.0	per cent	

Scenario 4 : Greater Share of Loans to Riskier Country Classes (year 5)

Low capitalization

Total assets/forfait	US$	1.55	billion
Net income	US$	32.3	million
Total capital	US$	404.3	million
Return on total capital	8.0	per cent	
Return on total earning assets/forfait	2.1	per cent	

High capitalization:

Total assets/forfait	US$	3.89	billion
Net income	US$	81.8	million
Total capital	US$	1,015.3	million
Return on total capital	8.1	per cent	
Return on total earning assets/forfait	2.1	per cent	

Scenario 5 : Lower Spreads on Loans (year 5)

Low capitalization

Total assets/forfait	US$	1.48	billion
Net income	US$	14.5	million
Total capital	US$	348.9	million
Return on total capital	4.1	per cent	
Return on total earning assets/forfait	1.0	per cent	

High capitalization:

Total assets/forfait	US$	3.72	billion
Net income	US$	37.0	million
Total capital	US$	876.4	million
Return on total capital	4.2	per cent	
Return on total earning assets/forfait	1.0	per cent	

Scenario 6 : Greater Use of the A Forfait Market (year 5)

Low capitalization

Total assets/forfait	US$	1.81	billion
Net income	US$	24.5	million
Total capital	US$	376.2	million
Return on total capital	6.5	per cent	
Return on total earning assets/forfait	1.4	per cent	

High capitalization:

Total assets/forfait	US$	4.54	billion
Net income	US$	62.2	million
Total capital	US$	945.4	million
Return on total capital	6.6	per cent	
Return on total earning assets/forfait	1.4	per cent	

Scenario 7 : Higher LIBOR (year 5)

Low capitalization

Total assets/forfait	US$	1.71	billion
Net income	US$	36.8	million
Total capital	US$	416.3	million
Return on total capital	8.9	per cent	
Return on total earning assets/forfait	2.1	per cent	

High capitalization:

Total assets/forfait	US$	4.30	billion
Net income	US$	93.2	million
Total capital	US$	1,045.4	million
Return on total capital	8.9	per cent	
Return on total earning assets/forfait	2.2	per cent	

Scenario 8 : Greater Loan Losses (year 5)

Low capitalization

Total assets/forfait	US$ 1.55	billion
Net income	US$ 22.7	million
Total capital	US$ 376.5	million
Return on total capital	6.0 per cent	
Return on total earning assets/forfait	1.5 per cent	

High capitalization:

Total assets/forfait	US$ 3.90	billion
Net income	US$ 57.9	million
Total capital	US$ 945.9	million
Return on total capital	6.1 per cent	
Return on total earning assets/forfait	1.5 per cent	

Scenario 9 : Longer Maturities and Greater Risk (year 5)

Low capitalization

Total assets/forfait	US$ 1.59	billion
Net income	US$ 38.8	million
Total capital	US$ 419.1	million
Return on total capital	9.3 per cent	
Return on total earning assets/forfait	2.4 per cent	

High capitalization:

Total assets/forfait	US$ 3.98	billion
Net income	US$ 98.2	million
Total capital	US$1,052.5	million
Return on total capital	9.3 per cent	
Return on total earning assets/forfait	2.5 per cent	

Scenario 10 : Problem Case (year 5)

Low capitalization

Total assets/forfait	US$ 1.41	billion
Net income	US$ 13.7	million
Total capital	US$ 355.6	million
Return on total capital	3.9 per cent	
Return on total earning assets/forfait	2.5 per cent	

High capitalization:

Total assets/forfait	US$ 3.54	billion
Net income	US$ 35.2	million
Total capital	US$ 893.2	million
Return on total capital	3.9 per cent	
Return on total earning assets/forfait	1.0 per cent	

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Item 8 (a) of the provisional agenda

OTHER MATTERS IN THE FIELD OF TRADE AND DEVELOPMENT:

(a) ECONOMIC CO-OPERATION AMONG DEVELOPING COUNTRIES:
- FINANCING OF SOUTH-SOUTH TRADE (PARAGRAPH 4 (c)(iii) OF RESOLUTION 4(V) OF THE COMMITTEE ON ECONOMIC CO-OPERATION AMONG DEVELOPING COUNTRIES)

Evaluation of performances and issues of trade financing in developing countries: the case for and the viability of an interregional facility

Report by the UNCTAD secretariat

Corrigendum

Paragraph 96, second sentence

For ten scenarios read eight scenarios

Subparagraph 97 (iv), first sentence

For 95 per cent read 75 per cent and for 5 per cent read 25 per cent

Idem, second sentence

Delete the second sentence.

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Subparagraph 97 (v), second sentence

Amend the second sentence to read as follows:

For the base case, short-term assets are allocated evenly at 25 per cent to each of the A-D risk-class countries, and the same even allocation was effected for the medium term.

Subparagraph 97 (vi), second sentence

The end of the second sentence should be completed to read as follows:

... the credit rating of the borrower from plus 8 per cent for class A to plus 3 per cent for class D.

Paragraph 98, second and third sentences

Delete the second and third sentences.

Paragraph 101, second sentence

Delete the phrase including the problem one.

Idem, third sentence

Amend the third sentence to read as follows:

In the fifth year, the after-tax rate of return on capital is 2.1 per cent in scenario 1 and 8.1 per cent in scenario 5, the high capital one. 17/

Idem, fourth sentence

For 1.0 per cent read 0.3 per cent

For 2.5 per cent read 2.1 per cent

For scenario 9 read scenario 5

Idem, last sentence

For US$7.9 billion read US$6.9 billion

Annex: Summary of individual scenario results

The whole annex should be replaced by the attached revised version.

Annex

SUMMARY OF INDIVIDUAL SCENARIO RESULTS

Base Case (year 5):

Total Assets/Forfait	$1.41 billion
Net Income	$13.7 million
Total Capital	$355.6 million
Return on Total Capital	3.9%
Return on Total Earning Assets/Forfait	1.0%

(Note that "Total Assets/Forfait" is equivalent to the total annual volume of financing.)

Since the Base Case assumes low capitalization, we compare the Base Case to the low-capitalization versions of the scenarios:

Scenario 1: Greater Leverage (year 5)

Total Assets/Forfait	$2.77 billion
Net Income	$7.34 million
Total Capital	$350.2 million
Return on Total Capital	2.1%
Return on Total Earning Assets/Forfait	0.3%

Scenario 2: Less Liquidity (year 5)

Total Assets/Forfait	$1.69 billion
Net Income	$14.0 million
Total Capital	$357.9 million
Return on Total Capital	3.9%
Return on Total Earning Assets/Forfait	0.8%

Scenario 3: Less Medium-Term Lending (year 5)

Total Assets/Forfait	$1.39 billion
Net Income	$9.76 million
Total Capital	$347.0 million
Return on Total Capital	2.8%
Return on Total Earning Assets/Forfait	0.7%

Scenario 4: Smaller Share of Loans to Riskier Country Classes (year 5)

Total Assets/Forfait	$1.48 billion
Net Income	$16.5 million
Total Capital	$354.6 million
Return on Total Capital	4.6%
Return on Total Earning Assets/Forfait	1.1%

Scenario 5: Higher Spreads on Loans (year 5)

Total Assets/Forfait	$1.55 billion
Net Income	$32.8 million
Total Capital	$410.4 million
Return on Total Capital	8.0%
Return on Total Earning Assets/Forfait	2.1%

Scenario 6: Greater Use of the A Forfait Market (year 5)

Total Assets/Forfait	$1.5 billion
Net Income	$13.2 million
Total Capital	$353.3 million
Return on Total Capital	3.7%
Return on Total Earning Assets/Forfait	0.9%

Scenario 7: Higher LIBOR (year 5)

Total Assets/Forfait	$1.54 billion
Net Income	$23.9 million
Total Capital	$389.1 million
Return on Total Capital	6.1%
Return on Total Earning Assets/Forfait	1.5%

Scenario 8: Shorter Maturities and Less Risk (year 5)

Total Assets/Forfait	$1.47 billion
Net Income	$11.9 million
Total Capital	$345.4 million
Return on Total Capital	3.5%
Return on Total Earning Assets/Forfait	0.8%

...

All of these scenarios are projected for high capitalization as well as low capitalization. Comparing the two versions of each scenario gives the following results:

Scenario 1: Greater Leverage (year 5)

Low capitalization:

Total Assets/Forfait	$2.77 billion
Net Income	$7.34 million
Total Capital	$350.2 million
Return on Total Capital	2.1%
Return on Total Earning Assets/Forfait	0.3%

High capitalization:

Total Assets/Forfait	$6.96 billion
Net Income	$19.2 million
Total Capital	$880.1 million
Return on Total Capital	2.2%
Return on Total Earning Assets/Forfait	0.3%

Scenario 2: Less Liquidity (year 5)

Low capitalization:

Total Assets/Forfait	$1.69 billion
Net Income	$14.0 million
Total Capital	$357.9 million
Return on Total Capital	3.9%
Return on Total Earning Assets/Forfait	0.8%

High capitalization:

Total Assets/Forfait	$4.3 billion
Net Income	$35.9 million
Total Capital	$899.3 million
Return on Total Capital	4.0%
Return on Total Earning Assets/Forfait	0.8%

Scenario 3: Less Medium-Term Lending (year 5)

Low capitalization:

Total Assets/Forfait	$1.39 billion
Net Income	$9.76 million
Total Capital	$347.0 million
Return on Total Capital	2.8%
Return on Total Earning Assets/Forfait	0.7%

High capitalization:

Total Assets/Forfait	$3.49 billion
Net Income	$25.1 million
Total Capital	$871.6 million
Return on Total Capital	2.9%
Return on Total Earning Assets/Forfait	0.7%

Scenario 4: Smaller Share of Loans to Riskier Country Classes (year 5)

Low capitalization:

Total Assets/Forfait	$1.48 billion
Net Income	$16.5 million
Total Capital	$354.6 million
Return on Total Capital	4.6%
Return on Total Earning Assets/Forfait	1.1%

High capitalization:

Total Assets/Forfait	$3.73 billion
Net Income	$42.1 million
Total Capital	$890.7 million
Return on Total Capital	4.7%
Return on Total Earning Assets/Forfait	1.1%

Scenario 5: Higher Spreads on Loans (year 5)

Low capitalization:

Total Assets/Forfait	$1.55 billion
Net Income	$32.8 million
Total Capital	$410.4 million
Return on Total Capital	8.0%
Return on Total Earning Assets/Forfait	2.1%

High capitalization:

Total Assets/Forfait	$3.89 billion
Net Income	$83.1 million
Total Capital	$1,030 million
Return on Total Capital	8.1%
Return on Total Earning Assets/Forfait	2.1%

Scenario 6: Greater Use of the A Forfait Market (year 5)

Low capitalization:

Total Assets/Forfait	$1.5 billion
Net Income	$13.2 million
Total Capital	$353.3 million
Return on Total Capital	3.7%
Return on Total Earning Assets/Forfait	0.9%

High capitalization:

Total Assets/Forfait	$3.85 billion
Net Income	$34.0 million
Total Capital	$887.9 million
Return on Total Capital	3.8%
Return on Total Earning Assets/Forfait	0.91.4%

Scenario 7: Higher LIBOR (year 5)

Low capitalization:

Total Assets/Forfait	$1.54 billion
Net Income	$23.9 million
Total Capital	$389.1 million
Return on Total Capital	6.1%
Return on Total Earning Assets/Forfait	1.5%

High capitalization:

Total Assets/Forfait	$3.87 billion
Net Income	$60.6 million
Total Capital	$977.6 million
Return on Total Capital	6.2%
Return on Total Earning Assets/Forfait	1.6%

Scenario 8: Shorter Maturities and Less Risk (year 5)

Low capitalization:

Total Assets/Forfait	$1.47 billion
Net Income	$11.9 million
Total Capital	$345.4 million
Return on Total Capital	3.5%
Return on Total Earning Assets/Forfait	0.8%

High capitalization:

Total Assets/Forfait	$3.68 billion
Net Income	$30.7 million
Total Capital	$867.3 million
Return on Total Capital	3.5%
Return on Total Earning Assets/Forfait	0.8%

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Our conclusion is that the ITFF could make a significant contribution toward closing the financing gap needed to permit developing countries to expand their non-traditional exports, particularly with each other.